Commonwealth Bank
Commonwealth Bank of Australia
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Secretariat

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Margaret Taylor
Group Company Secretary

31 January 2014

Attention: Peng Lee
Senior Manager Corporations
Australian Securities and Investments Commission
Level 24, 120 Collins Street
Melbourne VIC 3000

By email: policy.submissions@asic.gov.au

Dear Sir,

Submission from Commonwealth Bank of Australia ("CBA") in response to ASIC Consultation Paper 218: Employee incentive schemes ("CP218")

We set out below our comments on the proposals and issues raised in CP218. CBA considers the review undertaken by ASIC to be timely and, in broad terms, supports the proposals for regulatory change.

Since the introduction of ASIC Class Order 03/184 ("**Class Order**") and ASIC Regulatory Guide 49: Employee Share Schemes ("**RG 49**") approximately a decade ago, market practice in relation to the offering of employee incentive schemes has changed. ASIC's recognition of the need for updating policy guidance and approach is welcomed by CBA.

In addition, CBA would welcome a broad review of the taxation regime that applies to employee incentive schemes, in light of the fundamental changes that were made in 2009 and the Productivity Commission's recommendation in 2010 to remove the cessation of employment taxing trigger as part of its report on executive remuneration.[1]

1. CBA supports ASIC's 'Option 2' approach

CBA is broadly supportive of ASIC's review and consultation in relation to employee incentive schemes, and in particular the Class Order and RG49, as well as the proposed approach to relief and policy going forward. Further, CBA supports the continued policy objectives of creating an employer/employee relationship of mutual long term interdependence while maintaining employee and market protections. CBA operates various employee incentive plans and relies on the Class Order for relief from the disclosure, licensing, advertising and hawking provisions of the *Corporations Act* 2001 (Cth) for a number of plans. Specifically, CBA supports Option 2 of CP218:

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[1] CBA notes that Treasury announced on 21 January 2014 a consultation process with interested stakeholders regarding concerns relating to employee share scheme arrangements for startups. CBA would welcome further consultation into the taxation regime as it applies more generally to employee incentive plans.

Make certain substantive changes to the current relief – for the most part, to make it easier for employers and issuers to develop an employee incentive scheme but also to impose a limited number of new conditions to support the interests of participants who are considering taking up such a scheme.

2. C2Q1: extension to prospective employees

Do you agree with our proposal to extend our class order relief to cover offers to prospective employees? If not, why not?

CBA supports the extension of class order relief to cover prospective employees. The offer of participation in an employee incentive plan is at times part of the recruitment process for new employees and without expanded relief companies are often prevented from offering participation in plans in a simple and commercially desirable way (e.g. by making the offer at the time the offer of employment is made). Such a change is consistent with the employee share scheme tax rules which are drafted to accommodate offers to prospective employees.[2]

3. D3Q2: enhanced definition of performance right

Do you consider the proposed definition of 'performance right' is broad enough to cover the conditional rights usually offered under an employee incentive scheme? If not, what other rights do you think should be included in the definition? Please provide a detailed explanation of the nature of these rights and why they should be included.

CBA supports the broadening of relief to include offers of 'performance rights'. The current definition of 'eligible offer' in the Class Order is limited to offers of shares, options over shares, stapled securities and units of shares. In the past CBA has needed to seek and obtain individual ASIC relief to enable it to offer performance rights that were considered 'derivatives' and accordingly fell outside the current Class Order relief. In particular, relief was required to enable CBA to offer certain employees contractual rights ("**Rights**") to receive either:

- fully paid ordinary shares in the capital of CBA;
- a cash payment equivalent to the value of the CBA shares referred to above; or
- a combination of both the above.

Preparing applications for individual relief is time consuming and costly and these burdens would be alleviated through the proposed new definition. Accordingly, CBA is supportive of the new definition of 'eligible products' including performance rights.

4. F4Q2: offers for mutual benefit: minimum hold period of 12 months

Do you agree with our proposal that the relevant minimum period be 12 months? If not, why not? Would your response be different if the proposed minimum period were three years to further support our policy objective of ensuring offers are made for the purposes of creating a relationship of interdependence? If so, why?

CBA operates a number of employee incentive plans which, consistent with CBA's remuneration philosophy, are designed to align employee rewards with shareholder

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[2] Section 83A-10(2) of *Income Tax Assessment Act* 1997 (Cth).

interests. Generally, awards allocated under CBA's incentive plans vest either after a three or four year period. However, while this is the general rule there are some exceptions, e.g. in the case of cessation of employment or pursuant to good leaver provisions (e.g. death, disablement, redundancy). Accordingly, CBA does not support the introduction of a minimum 12 month holding period.

For example, under CBA's Employee Share Acquisition Plan ("**ESAP**"), eligible employees have the opportunity to receive up to $1,000 worth of CBA shares each year (at no direct cost to them) if the CBA Group meets required performance hurdles. Approximately 30,000 employees currently participate in, and hold shares pursuant to, the ESAP. The shares are subject to a holding restriction for a period of time being the earlier of:

- three years from the date of acquisition of the relevant shares by the participant; or
- the participant ceasing employment with the CBA Group.

This restriction is consistent with the minimum hold periods required under the tax legislation to permit the allocation of shares to count towards a reduction in assessable income.[3] This means that under the current plan rules, the shares become unrestricted and no longer subject to a holding period when an employee ceases to be employed by the CBA Group, irrespective of whether the shares have been held for less than three years (or even less than 12 months). Application of the proposed 12 month minimum hold period would have the consequences outlined below, and for these reasons, CBA is not supportive of this proposal:

- **Administrative burden:** As an example, if an employee were allocated $1,000 worth of shares in September 2014 at, say, $75 per share, this would mean that the employee would acquire an interest in 13 shares. If the employee were to cease employment with CBA in January 2015, under CBA's current policy (consistent with tax legislation, assuming other conditions are met), all 13 shares would become unrestricted on cessation of employment. Under ASIC's proposal, on cessation of employment, 25% (four shares, rounded up, at a value of approximately $300) would be restricted until September 2015, while nine shares would become unrestricted. Such a scenario would require that CBA administer (including notifying the registry provider and the participant) the removal of the restriction on the nine shares in January 2015 and the continuing restriction on the four shares until September 2015. In September 2015, CBA would be required to make arrangements for the lifting of the restriction on the four shares. This concept and the consequences for the employee's holdings would need to be communicated in a clear and effective way to participants in the plan.

- **Compliance and costs associated with participants holding less than marketable parcels:** The above example also illustrates that many participants might be left holding shares which were less than a 'marketable parcel' (as that term is defined in the ASX Operating Rules, currently being securities with a value less than $500). Similarly, brokerage payable by a former employee or participant who subsequently transfers their remaining holding once the restriction period had ended would be a substantial cost in comparison to the remaining small number of shares being transferred.

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[3] Section 83A-35(8) of *Income Tax Assessment Act* 1997 (Cth) and generally section 83A-35: Reduction of amounts included in assessable income. Section 83A-35(8) prescribes that, among other conditions, an interest in the shares not be disposed of until the earlier of 3 years from acquisition of the interest and cessation of employment by the participant's employer.

- **Salary/fee sacrifice plans:** It appears from CP218 that the 12 month holding would apply to shares acquired through contribution plans, eg employees who have acquired their shares through salary sacrifice arrangements, or directors who have acquired shares in lieu of part of their director fees (ie non-executive directors), even though these participants had legitimately used their own income to acquire the shares. While salary sacrifice plans usually involve mandatory holding restrictions (e.g. shares acquired are often restricted from sale for a minimum of two years and a maximum of seven years), such restrictions are usually removed where the employee ceases employment within the Group. Having employees and non-executive directors acquire and hold shares in the company assists to promote the principles of mutual interdependence with the company which ASIC and CBA support. CBA is concerned that additional restrictions on disposal of interests in shares, in particular when an employee is a 'good leaver' and early vesting of the shares is permitted, will dissuade voluntary participation in plans in these instances and reduce the interdependency ASIC has sought to promote. More generally, from a policy perspective, it would seem inappropriate to penalise 'good leavers' (who may be experiencing hardship) through mandatory holding requirements (even under tax deferral plans).

- **Prospective employees disadvantaged:** In some instances CBA may wish to match a new employee's existing share vesting arrangements from their previous employer as a recruitment incentive. For example, if a prospective employee forfeits a defined set of shares as a result of ceasing employment with a previous employer to commence employment with CBA, and that parcel of shares was due to vest in say eight months from the time of employment transition, CBA may wish to offer a parcel of shares to the new employee comparable in value and vesting / holding periods to the forfeited shares. Under the proposed holding restriction, CBA would not be able to offer the prospective employee similar benefits.

- **Inconsistency with tax approach:** As described above, the mandatory holding period does not align with the current tax regime. For example, in the case of:

    - \$1,000 plans, the 12 month restriction does not align with the Income Tax Assessment Act [4]; and
    - tax deferral plans, the Australian Taxation Office ("**ATO**") guidelines suggest that a minimum term of employment of at least six months may be sufficient to support tax deferral for a maximum period of three years.[5]

- **Takeover bids:** Many of CBA's employee incentive plans contain provisions, which are common in the market, that give the Board the power to accelerate vesting in the event of a takeover (eg if a takeover bid is recommended by the Board and becomes unconditional) or scheme of arrangement. CBA considers this power appropriate and necessary to facilitate such an event.

CBA considers that there should be no restriction on the ability to deal in the securities post cessation of employment. However, if ASIC persists with introducing the 12 month restriction, there should be carve outs to this rule. For example, ASIC may consider appropriate carve outs to be:

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[4] Section 83A-35(8) of the *Income Tax Assessment Act* 1997 (Cth).

[5] See ATO's release on Employee share schemes "Minimum Term of employment."

- 12 month holding restrictions apply only to holdings over a threshold amount e.g. holdings of shares acquired in excess of $1,000 per year;
- shares acquired through a salary sacrifice/fee sacrifice arrangement would be excluded from the restriction; and
- shares that would otherwise be permitted to vest under plan rules, where the participant ceased employment with the organisation and was classified as a 'good leaver' or in a takeover context, would be excluded from the restriction.

Consistent with our reasons outlined above, CBA does not support the introduction of an even longer hold period of three years.

5. F5Q1: disclosure to participants and ASIC

Do you agree with our requirement that the offer document should be clear, concise and effective, and include a brief summary of the key risks? If not, why not?

CBA supports the requirement that the offer document should be clear, concise and effective, and supports the principle of effective and appropriate risk disclosure for holders of listed securities. CBA considers that the introduction of a requirement that the offer document include a brief summary of the key risks should be limited to a high level summary of the risks involved in holding shares. In CBA's view, a brief summary of the key risks would be along the lines of disclosure that the price of listed shares can be volatile by nature, the price can fluctuate over the short and long term and that the payment of dividends can go up and down, or may cease to be paid for a period of time.

As a disclosing entity, CBA provides disclosure in accordance with its obligations under the Corporations Act and the ASX Listing Rules, including disclosure of risks, by a variety of means including ASX disclosures and in its annual reports. CBA considers that a cross reference to disclosure already available by other publicly available means would be a more appropriate and adequate means of providing participants with company information, including risk disclosure, for detail in addition to the high level risks outlined above.

Margaret Taylor
Group Company Secretary